IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No. 88

CHARLES E. SPRINGER, et al., constituting the NORTHERN PACIFIC STOCKHOLDERS' PROTECTIVE COMMITTEE, *Appellants*,

v.

UNITED STATES OF AMERICA, et al., *Appellees*.

On Appeal from the United States District Court for the District of Columbia

REPLY BRIEF FOR APPELLANTS

LOUIS B. DAILEY
335 Broadway
New York, N. Y. 10013

HARRY TYSON CARTER
1815 H Street, N.W.
Washington, D. C. 20006

Of Counsel:

SHARFMAN & FISHER
1815 H Street, N.W.
Washington, D. C. 20006

Printed by Merrill B. Adams Foundation, Inc., Washington, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No. 38

CHARLES E. BRUNDAGE, et al., constituting the NORTHERN PACIFIC STOCKHOLDERS' PROTECTIVE COMMITTEE, *Appellants,*

v.

UNITED STATES OF AMERICA, et al., *Appellees.*

On Appeal from the United States District Court for the District of Columbia

---

REPLY BRIEF FOR APPELLANTS

INTRODUCTION

A new claim made by appellees in their briefs and several facts occurring since the filing of the Committee's brief appellants believe require a reply brief.

This claim and these facts are directly related to the method of valuing the respective contributions currently being made by the parties to the merger in determining just and reasonable stock exchange ratios, one of the fundamental issues on this appeal. They also aggravate the grave injustice to Northern Pacific stockholders in the denial of a further hearing to update the record as to such stock exchange ratios.

ARGUMENT

I. The New Claim of Appellees in Their Briefs That the Parties Adopted Weighted Earnings as the Principal Basis for Fixing Stock Exchange Ratios Has No Support in the Record.

For the first time in the eight year history of the administrative and court proceedings in this case, without reference to any testimony or exhibits in the record, the applicants state at page 8 in their brief that "the parties adopted *weighted* earnings as the principal basis for fixing exchange ratios (App. 294-5, 802)" (emphasis supplied), citing merely portions of the Examiner's Report and the Commission's decision.* Neither of these citations mentions or suggests the idea of "weighted" earnings. They merely refer to "earnings" (sic) as a basis of value, as distinguished from property or asset values. There is nothing here or elsewhere in the record made by the applicants, attempting to prove that the earnings of railroad properties and the earnings of natural resources properties are affected by different factors and should therefore be given different weights in measuring the contributions of the stockholder groups in the merger or that this was, in fact, the basis of the negotiations resulting in the merger terms agreed upon.

This distinction was the substance of much of the Committee's evidence and one of the bases of its determinations of appropriate stock exchange ratios based solely on evidence of record (Tr. 9916-22; 9982-10002; Com. Brief, App. VII).

Applicants, in groping desperately for some support in the record for this new "weighted" earnings

* "The Commission at page 116 of its brief also, for the first time, makes the same claim and also cites nothing in the record to sustain it."

theory, at page 28 in their brief refer to the testimony of Mr. Dobson, the witness for Great Northern's financial advisor, First Boston Corporation, *elicited on cross-examination.* He testified that First Boston thought that natural resource income should be given a weight of about 1½ to 1 for railroad income (Tr. 2572). This was arrived at purely as a matter of judgment (Tr. 2575)—not on the basis of any study of market transactions in stocks of companies having similar properties such as the Committee's expert had made (Tr. 9982-10001). But Mr. Dobson had no view as to what was a fair price-earnings ratio on which to capitalize the earnings of Northern Pacific's natural resources at the time he gave his advice on the proposed merger terms (Tr. 2574). First Boston took no active part in the negotiations that determined the proposed merger terms and was hired explicitly only to advise Great Northern as to *any* terms that might be agreed on (Tr. 2543-6).

At no place in the record is there any evidence of the applicants as to what might be an appropriate price-earnings ratio to be applied to the earnings from Northern Pacific's natural resources properties. In their brief at page 28 they characterize as absurd the Committee's testimony of a price-earnings ratio of 50, based on market comparisons with stocks of other companies having similar assets, but they produced for the record in rebuttal no different price-earnings ratio than the Committee's ratio, although expert representatives of Morgan Stanley and First Boston Corporation were available to testify.

In this case the properties being contributed are of greatly disparate character: railroad and natural resources.

The applicants' evidence was that the stock exchange ratios were determined primarily on the basis of the earnings of the two companies rather than on property or asset values; that the attempt to arrive at comparative values of the two stocks by separately valuing the natural resources properties of Northern Pacific proved impractical because of the inability to agree and the difficulty of such valuation and the uncertainty of future potentials of such properties; that no "definitive valuation" of the natural resources properties was made by either of the two parties and that in the last analysis the stock exchange ratios had to be a matter of "judgment" (Tr. 117-18).

As to valuation of railroad properties, the Committee's testimony raised no issue, agreeing with applicants that capitalization of earnings therefrom was the most appropriate method of valuation (Tr. 117-18, 9916, 10022). The Committee's testimony, undisputed in the record, was that a price-earnings ratio of 15 was appropriate at that time in capitalizing railroad earnings (Tr. 10022).

As to the valuation of natural resources properties, the Committee's evidence showed that different factors were involved than with railroad properties dedicated to the public use, and that the *market* or *asset* values of the natural resources properties, particularly where undeveloped, more nearly reflected the value of the contributions being made by Northern Pacific stockholders, but that if only *earnings* of such properties were to be used in valuation, a much higher price-earnings ratio must be, and is in the market place, applied to such earnings to take into account the future potential earnings of such properties not currently productive of income (Tr. 9988-9).

How important this matter is to the proper valuation of those Northern Pacific properties having oil and gas potentials but not now producing any earnings is shown by a dramatic event that has occurred since the filing of the Committee's brief:

On or about September 17, 1969, the State of Alaska accepted 164 out of 179 offers, made by most of the biggest American oil companies, for oil and gas leases covering *415,453* acres in the North Slope area of Alaska at an aggregate price of *$900,041,604.29* (*Wall Street Journal,* September 18, 1969, p. 4, col. 2).

This confirms the Committee's evidence on this point, i.e. that a knowledgeable buyer will pay a handsome price for mineral interests in lands not currently producing earnings (Tr. 9989).

II. Applicants' Brief Perpetuates an Erroneous Statement in the Examiner's Report, Vital as to Valuation and Unsupported in the Record, That the Natural Resources Properties Are Not Readily Marketable and Are Worth Only What They Earn.

At page 8 in applicants' brief, just after the statement that the parties adopted "weighted earnings" as the principal basis for fixing exchange ratios, it is stated, citing only the examiner's report:

> "In adopting this basis, the parties recognized that a definitive valuation of either the railroad properties or the natural resources properties was at best difficult, and probably impossible, and that, in any event, since *neither class of property was readily saleable,* both were basically worth what they could earn (App. 792)." (Emphasis supplied)

In his report the examiner misstated the record as to the marketability of the natural resources properties when he said:

> "Significantly, a definitive valuation of either Great Northern or Northern Pacific stock except

> on the basis of capitalization of earnings, was determined to be difficult if not impossible to make because of the diversity of the assets involved and the fact that neither railroad properties *nor the natural resources* were readily marketable and are worth only what they earn" (App. 792). (Emphasis supplied)

But in the record, Mr. Macfarlane, the applicants' witness on this point, did not so testify. What he did say was:

> "A definitive valuation of either Northern Pacific or Great Northern stock, except on the basis of capitalization of earnings, is difficult if not impossible to make because of the diversity of the assets involved and the fact that *properties dedicated to railroad use* are not readily marketable and are worth only what they can earn" (Tr. 117-18). (Emphasis supplied)

The Committee agrees that properties dedicated to *railroad* use, are not readily marketable and are worth only what they can earn.

This serious error on a vital matter was pointed out to the Commission in the Committee's exceptions to the examiner's report, but was never corrected by it or the District Court and is now being carried forward even to this Court.

Morgan Stanley had no doubt that these natural resources properties could be sold to a third party and stated in their report that in essence a sale of the interest of Northern Pacific in such properties to Great Northern stockholders would take place in the merger and "on this basis, *Northern Pacific stockholders should realize sale value rather than value based on capitalization of earnings*" (Ex. 32, p. 3). (Emphasis

supplied) This conclusion is reinforced by the Committee's testimony concerning what was in effect a sale of very substantial oil and gas interests in the merger of TXL Oil Corp. into Texaco, Inc., two large knowledgeable companies (Tr. 9985-90).

III. The Denial of Due Process to Northern Pacific Stockholders by Refusal to Allow a Further Hearing Is Aggravated by Recent Admissions by Northern Pacific of Great Current Value of Its Coal Reserves as to Billions of Tons of Which No Value Was Assigned in Negotiating the Proposed Merger Terms.

The Northern Pacific management prepared a report in March 1959 used in the negotiations putting an "ultra-conservative" value of $957,000 on its leased coal lands and an aggregate value of $4,000,000 on two coal mines operated by it with estimated reserves of only 163 million tons, assigning no value to coal deposits in lands not then under lease (Ex. 31, pp. 2-3).

Morgan Stanley used these figures in recommending to Northern Pacific management that it should not merge at all unless Northern Pacific stockholders would receive in the exchange slightly more stock of the new company than Great Northern stockholders would receive (Ex. 32, pp. 18, 28). Mr. Dobson of First Boston Corporation, the Great Northern's financial advisor, testified he gave no consideration to the existence of the billions of tons of coal reserves not under lease in giving his advice on the final merger terms (Tr. 2582).

Referring to Exhibit 31, Mr. Macfarlane, chief negotiator for Northern Pacific, testified in 1961 on cross-examination as follows:

> "Q. Under the second item on Page 2, Mr. MacFarlane, titled 'Leased Coal Land' valuation of coal lands is stated to be based only on coal de-

posits actually under lease. Why were not coal lands not under lease valued and included?

A. Because we can't lease them. I wish we could. We have this lignite which is a subtype of coal. The United States Government is willing to lease those for royalty basis of *ten cents a ton* but none is even being leased on that basis, so there is no income and *there is no potential income in those coal lands in that area.* In the area in Washington State where we do have bituminous coal lands and have our own coal mine, we are losing $150,000 a year in that operation, and if you would like to acquire it I would be delighted to sell it to you for whatever you want to pay" (Tr. 1063). (Emphasis supplied)

Now, contrast this record evidence with a recent assertion by Northern Pacific. At page 8 in the May issue, Volume 1, Number 1, of a magazine "GO", published by Northern Pacific and released in June 1969, appears for the first time a specific estimate by Northern Pacific management of its minable coal reserves:

"Lots of people around the country think coal's a dead issue. But they should see some of the NP geological reports and leases. Already this department [Resources Development Department] has located and leased billions of tons of lignite and bituminous and sub-bituminous coal. Some 3.5 billion tons are under lease to such companies as Peabody, Consol and Montana Power. *But NP estimates it has something like 10 billion tons of minable coal reserves in North Dakota, Montana and Washington. And some of the biggest names in coal and oil are after it right now.*" (Emphasis supplied)

Some idea of the magnitude of the value of this one category of Northern Pacific's natural resources prop-

erties can be gleaned from recent dealings with these coal reserves.

According to the minutes of the meeting of the Board of Directors of Northern Pacific held on December 12, 1968 the Board considered a coal exploration agreement running to August 31, 1970 with Humble Oil & Refining Co. on 185,072.53 acres in Custer, Dawson, Garfield, McCone, Prairie, Rutland and Rosebud Counties in Montana and 31,137 acres in Dunn, Slope and Stark Counties in North Dakota containing an option to lease with a base royalty of *19¢ per short ton* subject to escalation and authorized the President and Vice President to further negotiate and consummate an agreement if the terms were favorable in their judgment.

At the same meeting the Northern Pacific Board approved a lease to Consolidation Coal Co. covering 11,000 acres in Rosebud County, Montana, for 20 years from January 1, 1969 with a royalty of *21¢ per short ton* for the first 5 years and increasing 1½¢ per ton for each 5 years thereafter.

Thus it appears that currently Northern Pacific has under lease 3.5 billion tons of these minable coal reserves with at least another 6.5 billion tons* available for leasing. In the absence of information as to the earnings being received from the leased lands and as to the estimated life of these coal reserves, if the present discounted value of all minable coal reserves, leased and unleased, were deemed to be only *1¢ per short ton,* the estimated 10 billion tons of such reserves would have a present value of $100,000,000. This figure contrasts sharply with the aggregate value of $4,957,000 used for

* It is not clear from the quoted article from "GO" whether the 3.5 billion tons under lease is included in or excluded from the estimated minable coal reserves of 10 billion tons.

all of Northern Pacific's coal interests in negotiating the proposed merger terms. All of these minable coal reserves can and should be valued more precisely and currently on a remand to the Commission.

The record shows that the proposed stock ratios were negotiated at a time when the coal mining industry was at its "lowest ebb in the last half century" and on a basis that no value was assigned to coal rights in lands, not then under lease, containing billions of tons of lignite, subbituminous and bituminous coal on the erroneous assumption that there was "no potential income in those coal lands". Then these reserves had not even been estimated. Similar interests were then being offered by the United States Government at *10¢ a ton* without any takers (Ex. 145, Part C, pp. 7-8; Ex. 31, p. 2; Tr. 1063).

Evidence now available, but not presently allowed in the record, shows that billions of tons of minable coal reserves are being actively sought after by "the biggest names in coal and oil," including Consolidation Coal Co. and Humble Oil & Refining Co. at royalties escalating from *21¢ and 19¢ per ton* (Northern Pacific magazine "GO" p. 8; Minutes of December 12, 1968 meeting of Northern Pacific Board of Directors).

Noteworthy also is the fact that the net income from "Other Minerals", which includes these minable coal reserves, went from $45,538 in 1961 when Mr. Macfarlane was testifying to $559,000 in 1968, before any income was receivable from Consolidation Coal Co. and Humble Oil & Refining Co. as mentioned above (Com. Brief, App. V).

CONCLUSION

Appellees' new claim in their briefs that the merger terms were negotiated on the basis of a "weighted" earnings method of valuation is not supported in the record and reinforces the Committee's position that there is not substantial evidence in the record to support any finding that the stock exchange ratios of the proposed merger are just to Northern Pacific stockholders, whether based on market asset values or capitalization of earnings, and Northern Pacific management's own recent admissions as to current asset values demonstrate that Northern Pacific stockholders have been denied due process in the denial of its petitions for a further hearing.

For these additional reasons, the judgment of the District Court should be reversed, the prayers of the appellants' complaint should be granted and the matter should be remanded to the Interstate Commerce Commission for further action in accordance with the directions of the Court.

Respectfully submitted,

LOUIS B. DAILEY
335 Broadway
New York, N. Y. 10013

HARRY TYSON CARTER
1815 H Street, N.W.
Washington, D. C. 20006

Of Counsel:

SHANLEY & FISHER
1815 H Street, N.W.
Washington, D. C. 20006